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IN THE

Supreme Court of the United States

OCTOBER TERM, A. D. 1937.

No. 30

UNITED STATES OF AMERICA, on relation of Chester A. Willoughby, as Trustee in Bankruptcy of National Mechanical Service Company, a corporation, et al.,

Petitioners,

vs.

SAM HOWARD and CONTINENTAL CASUALTY COMPANY, a corporation,

Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

BRIEF FOR PETITIONERS.

OPINIONS BELOW.

The judgments of the District Court appear in the record. (R. 56, 384.) No opinion was rendered by said Court.

The opinion of the Circuit Court of Appeals is reported in 87 F. (2d) 243. (R. 393.)

JURISDICTION.

The date of the decree of the Circuit Court of Appeals for the Seventh Circuit (R. 393) sought to be reviewed was January 8, 1937, and a rehearing was denied on January 29, 1937. (R. 406.)

The petition for a writ of certiorari was filed April 20, 1937, and was granted May 24, 1937.

The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925. (28 U. S. C. A., Sec. 347 (a).)

STATUTES INVOLVED.

Section 47 Bankruptcy Act, 11 U. S. C. A. 75:

"(a) Trustees shall respectively (1) account for and pay over to the estates under their control all interest received by them on property of such estates; (2) collect and reduce to money the property of the estates for which they are trustees, under the direction of the court, and close up the estate as expeditiously as is compatible with the best interests of the parties in interest; * * * (3) deposit all money received by them in one of the designated depositories; (4) disburse money only by check or draft on the depositories in which it has been deposited; (5) furnish such information concerning the estates of which they are trustees and their administration as may be requested by parties in interest; * * * (7) lay before the final meeting of the creditors detailed statements of the administration of the estates; * * * (10) report to the courts, in writing, the condition of the estates and the amounts of money on hand, and such other details as may be required by the courts, within the first month after their appointment and every two months thereafter, unless otherwise ordered by the courts; * * *."

Section 61 Bankruptcy Act, 11 U. S. C. A. 101:

"*Depositories for money.* Courts of bankruptcy shall designate, by order, banking institutions as depositories for the money of bankrupt estates, as convenient as may be to the residences of trustees, and shall require bonds to the United States, subject to their approval, to be given by such banking institutions, and may from time to time as occasion may require, by like order increase the number of depositories or the amount of any bond or change such depositories. (July 1, 1898, c. 541, sec. 61, 30 Stat. 562.)"

Section 70 Bankruptcy Act, 11 U. S. C. A. 110:

"(a) The trustee of the estate of a bankrupt, upon his appointment and qualification, and his successor or successors, if he shall have one or more, upon his or their appointment and qualification, shall in turn be vested by operation of law with the title of the bankrupt, as of the date he was adjudged a bankrupt, except in so far as it is to property which is exempt, * * *."

Title 31 U. S. C. A.—Money and Finance—Sec. 476:

"*Transfer of duties of assistant treasurers to other officers, etc.* The Secretary of the Treasury may, in his discretion, transfer any or all of the duties and functions performed or authorized to be performed prior to May 29, 1920, by assistant treasurers at Boston, New York, Philadelphia, Baltimore, New Orleans, Saint Louis, San Francisco, Cincinnati, and Chicago, or their offices, to the Treasurer of the United States or the mints or assay offices of the United States, under such rules and regulations as he may prescribe, or may utilize any of the Federal reserve banks acting as depositaries or fiscal agents of the United States, for the purpose of performing any or all of such duties and functions, notwithstanding the limitations of sections 391 and 392 of Title 12, or any other provisions of law. (May 29, 1920, c. 214, Sec. 1, 41 Stat. 655.)"

Title 12 U. S. C. A.—Banks and Banking—Sec. 391:

"Federal reserve banks as Government depositaries and fiscal agents

"The moneys held in the general fund of the Treasury, except the 5 per centum fund for the redemption of outstanding national-bank notes and the funds provided in this chapter for the redemption of Federal reserve notes may, upon the direction of the Secretary of the Treasury, be deposited in Federal reserve banks, which banks, when required by the Secretary of the Treasury, shall act as fiscal agents of the United States; and the revenues of the Government or any part thereof may be deposited in such banks, and disbursements may be made by checks drawn against such deposits. (Dec. 23, 1913, c. 6, sec. 15, 38 Stat. 265.)"

Title 12 U. S. C. A.—Banks and Banking—Sec. 392:

"Depositaries of Government funds as confined to banks in Federal reserve system; member banks as depositaries

"No public funds of the Philippine Islands, or of the postal savings, or any Government funds, shall be deposited in the continental United States in any bank not belonging to the system established by this chapter: *Provided, however,* That nothing in this chapter shall be construed to deny the right of the Secretary of the Treasury to use member banks as depositories. (Dec. 23, 1913, c. 6, Sec. 15, 38 Stat. 265.)"

PRINCIPAL QUESTION PRESENTED.

Does the fact that a trustee or receiver in bankruptcy deposits and maintains the funds of his estates in one of several designated depositories relieve him and his surety from liability upon his official bonds, which are conditioned upon the faithful performance of his duties, for loss of estate funds occasioned by the failure of the particular depository in which he chooses to keep

such funds when such depository was selected and the estate funds were deposited and maintained therein negligently or in disregard of the known financial weakness of such depository or pursuant to a corrupt agreement made by the trustee or receiver for his personal benefit.

STATEMENT.

Three suits at law were brought in the United States District Court for the Northern District of Illinois, Eastern Division, in the name of United States of America on the relation of Chester A. Willoughby, acting in his capacity as Trustee in Bankruptcy of 114 bankrupt estates and as Receiver in Bankruptcy of 9 other bankrupt estates, against Sam Howard, one of the respondents herein, upon his official bonds as Trustee in Bankruptcy and as Receiver in Bankruptcy of said bankrupt estates, and against Continental Casualty Company, a corporation, the other respondent herein, as surety upon all of said official bonds.

During the month of May, 1934, Howard resigned as trustee or receiver in all of said estates and was succeeded by Chester A. Willoughby who, as such trustee and receiver, is the petitioner herein. All of said bankrupt estates were subject to the jurisdiction of the District Court of the United States for the Northern District of Illinois, Eastern Division. These three suits involve all 123 of said estates, and, by agreement of all the parties, were consolidated for trial, and tried by said District Court. (R. 51.)

The undisputed evidence, largely testimony of the defendant Howard and other testimony given on behalf of the defendants, showed as follows:

That prior to August 25, 1930, Howard as trustee and receiver kept funds of his bankrupt estates

on deposit in the Central Trust Company of Illinois and the Foreman-State National Bank, both of which were banking corporations located in Chicago, Illinois. (R. 169, 256-258.) He had personal unsecured loans of $2,500.00 at the Central Trust Company and of $7,000.00 at the Foreman Bank. (R. 258.)

That shortly prior to July 15, 1930, Clarence A. Beutel, a vice president of the Central Trust Company, advised Howard that he anticipated becoming president of the Phillip State Bank and Trust Company of Chicago (hereinafter called the "Phillip Bank") and invited Howard to change his estate deposits from the aforesaid banks to the Phillip Bank (R. 164, 256), although at that time the Phillip Bank was not a depository qualified to accept the funds of bankrupt estates. (R. 143.) Howard replied that he was not a man of any means and if he transferred his estate deposits to the Phillip Bank he would wish to obtain an unsecured loan from that bank to liquidate his other loans above mentioned. (R. 257.) Beutel told Howard that the Phillip Bank would make him a loan so that he could liquidate said loans with the Central Trust Company and the Foreman Bank (R. 165, 257) and also would loan him such further sums as Howard required to conduct his business.

That a like understanding was entered into between Howard and Bernard L. Rosset, chairman of the board of the Phillip Bank. (R. 203.)

As a result of said arrangement between Howard and Beutel, the Phillip Bank loaned $5,000.00 to Howard on his unsecured note on August 6, 1930, and loaned him the further sum of $6,000.00 on August 19, 1930, a total of $11,000.00 as against the total loans of $9,500.00 which Howard then had with the Central Trust Company and Foreman Bank. (R. 77, 79, 258.)

Thereafter, on August 20, 1930, the Phillip Bank filed a bankruptcy depository bond for $50,000.00 (R. 113) and qualified to act as such depository. Between August 25,

and August 31, 1930, Howard deposited in the Phillip Bank, in his capacity as trustee or receiver of said estates, the sum of $249,968.15. (R. 73.)

The last published statement of the financial condition of the Phillip Bank prior to the making of said deposits, was as of June 30, 1930, and showed liabilities of $4,367,897.93, of which $1,610,294.96 were demand deposits, and $1,858,076.90 were time deposits. (R. 84.)

Commencing with the initial deposits of $249,968.15, the deposits in the Phillip Bank of Howard as trustee or receiver increased until at the time said bank failed on June 21, 1932, said deposits amounted to $416,833.90, the largest deposits Howard had in said bank at any time. (R. 72.)

The original personal unsecured loans of $11,000.00 made to Howard in August, 1930, increased to $18,515.00 on July 11, 1931, and amounted to $17,500.00 on June 21, 1932, the date said bank failed. (R. 77, 78.)

During the period that Howard was increasing his deposits as trustee and receiver in the Phillip Bank, said bank underwent five serious runs. A run in April, 1931 (R. 169) required the borrowing of $1,000,000.00. Another run occurred in June, 1931. (R. 171, 176.) A run in September, 1931 (R. 176, 177) required the borrowing of about $500,000.00; and a run in December of 1931, cost the bank $500,000.00 (R. 177.) The fifth run resulted in the failure of the bank on June 21, 1932. (R. 178.)

Howard had knowledge of each of these runs (R. 169, 171, 173, 176, 177, 192, 193) and discussed them with officers of the bank (R. 259-263), and, in addition, was charged with knowledge of the publications required by the Auditor of Public Accounts of the State of Illinois

of the condition of the bank (R. 271), said publications showing the condition of said bank as of the following dates: June 30, 1930 (R. 84); September 24, 1930 (R. 86); December 31, 1930 (R. 89); March 25, 1931 (R. 91); June 30, 1931 (R. 93); September 29, 1931 (R. 96); December 31, 1931 (R. 98); and March 30, 1932 (R. 100). Said statements in each instance were published shortly after the date as of which they were made. Howard admitted that he had received the quarterly reports and indicated that he had looked at them and then thrown them away. (R. 271.)

While Howard was increasing the amount of estate moneys deposited in said bank and increasing his personal borrowing therefrom, its demand and time deposits, as a whole, were decreasing. On March 25, 1931, demand deposits were $2,481,918.79 and time deposits were $1,329,-$720.39. (R. 92.). On December 31, 1931, demand deposits had decreased to $1,938,427.13, of which $252,461.18 were deposits of said Howard's estates, and time deposits had decreased to $655,357.11. (R. 72, 98.) At the time said bank closed the total deposits, both demand and time, were $2,101,710.51, of which $416,833.90 were deposits of Howard's estates. (R. 72.) From August, 1930, to the closing of the Phillip Bank, Howard's estates were from 13.98% to 25.65% of all demand deposits and from 28.09% to 74.21% of the cash and government securities held by said bank. (R. 72.)

The moneys of 123 bankrupt estates here involved are a portion but not all of the estate moneys which Howard had on deposit with the Phillip Bank. (R. 72.)

No evidence was offered to show that any loss ever was suffered by any depositor in the Central Trust Company or Foreman Bank.

After the failure of the Phillip Bank, its $50,000.00 depository bond was collected and paid in reduction of the loss to the bankrupt estates whose money was on deposit in said bank, which resulted in a distributive dividend to each of said estates of 11.0461% of the estate money on deposit. (R. 13-28, 61, 67.) The amount for which suit was brought in these cases was the amount on deposit in each of the estates here involved at the time the Phillip Bank failed, less the amount of such distributive dividend, except in the case of estates in which the trustee's or receiver's bond was less than the amount on deposit after crediting the above-mentioned distributive dividend, in which case the amount sued for was the full amount of the bond. (R. 61-64, 67.) The amount sought to be recovered was $5,439.22 on the trustee's bond in one suit (R. 61), $197,076.31 on 113 trustee's bonds in another suit. (R. 64), and $23,224.92 on 9 receiver's bonds in a third suit (R. 67), an aggregate of $225,740.45.

The conditions of the official bonds of Howard as trustee or receiver were in substance that he and his surety were to be liable for losses resulting to said estates upon:

(a) Failure of Howard to obey any order of the Court.

(b) Failure of Howard faithfully and truly to account for all of the moneys, assets or effects of the estates.

(c) Failure of Howard in all respects faithfully to perform all of his official duties as trustee or receiver. (R. 59, 65.)

The complaint set forth in separate counts the deposit of each estate in the Phillip Bank and other factual data sufficient to establish the amount of the loss suffered by each estate as a result of the closing of said bank and

the portion of such loss covered by Howard's official bonds. Said complaint also set forth the relationship of Howard to the Phillip Bank, the history of the runs thereon and the fact that Howard knew of the condition of said bank, and alleged that he negligently and carelessly permitted the moneys of said estates to remain on deposit in said bank, that he did not faithfully and fully account for the moneys of the estates, did not faithfully perform his duties as trustee or receiver, did not report in writing the condition of the estates, and that he did not exercise reasonable care, prudence and caution in his official capacity.

The jury rendered verdicts for the plaintiffs in each of said three suits, in the aggregate amount of $225,740.45 (R. 52, 383), the full amount claimed, and judgment was entered for the plaintiffs in the full amount of said verdicts. (R. 56.)

The defendants appealed to the United States Circuit Court of Appeals for the Seventh Circuit, said appeal being argued before the Court on May 19, 1936, Judges Evans and Lindley sitting. (R. 391.)

Thereafter, said Court ordered a re-argument of said appeal, which was heard on November 18, 1936, by Circuit Judge Evans and District Judges Lindley and Briggle. (R. 392.) On January 8, 1937, Circuit Judge Evans filing a dissenting opinion (R. 402), the Circuit Court of Appeals reversed the judgment of the District Court and remanded the case for a new trial, in accordance with directions contained in said opinion, said directions in substance being to direct a verdict for the respondents and not to submit to the jury the question of whether Howard was negligent in making deposits in a designated depository. (R. 393.) The plaintiffs thereupon petitioned the

Court for a rehearing which was denied on January 29, 1937. (R. 406.)

Thereafter, on May 24, 1937, this Court granted the petition of said Chester A. Willoughby, as Trustee in Bankruptcy, *et al.*, for a writ of certiorari to said Circuit Court of Appeals.

SPECIFICATION OF ERRORS TO BE URGED.

The Circuit Court of Appeals erred:

(a) In reversing the judgment of the District Court.

(b) In holding that the loss of estate moneys because of the failure of a trustee or receiver in bankruptcy faithfully to perform his official duties, is not chargeable to his surety.

(c) In holding that loss resulting from the failure to exercise ordinary care, or from negligence of a trustee or receiver in bankruptcy in depositing or maintaining deposits of his estate moneys, is not chargeable to his surety.

(d) In holding that the loss of estate moneys resulting from corrupt agreements or acceptance of personal favors by a trustee or receiver in bankruptcy in consideration of depositing and maintaining bankrupt funds in a particular depository among several, is not chargeable to his surety.

(e) In holding that the surety on a bond of a trustee or receiver in bankruptcy cannot be charged for the loss of bankruptcy funds resulting from negligence or malfeasance in office of the trustee or receiver in bankruptcy in depositing and maintaining excessive amounts belonging to numerous estates in one designated depository when there was a choice available among a number of such depositories.

(f) In holding that under the provisions of the Bankruptcy Act, the surety can constitutionally be relieved by the Bankruptcy Act for negligence or malfeasance in office, resulting in the loss of bankruptcy funds, committed by a trustee or receiver in bankruptcy in depositing and maintaining of bankruptcy (private) funds in a designated depository.

SUMMARY OF ARGUMENT.

I.

The Circuit Court erred in setting aside the judgment of the District Court based upon the verdict of the jury.

II.

Howard violated each of his official bonds.

A. *Howard failed to obey the orders of the Court.*

B. *Howard failed to account.*

C. *Howard failed to perform his official duties.*

III.

The liability of his surety is coextensive with that of the Trustee or Receiver in Bankruptcy in respect of all losses resulting from official acts or omissions of such Trustee or Receiver.

A. *The surety company's liability.*

B. *The opinion of the Circuit Court.*

C. *The Federal rule as to the liability of sureties on official bonds.*

IV.

Negligence, or a failure to exercise ordinary care in the performance of a statutory duty, entering into corrupt agreements, accepting personal favors, or accepting compensation other than as allowed by law are violations of the official bond of a Trustee or Receiver in Bankruptcy.

V.

The public fund depository system (31 U. S. C. A. Sec. 476) and the plan provided in Section 47 of the Bankruptcy Act (11 U. S. C. A. Sec. 75) and Section 61 of the Bankruptcy Act (11 U. S. C. A. Sec. 101) have no direct relationship to each other.

VI.

Neither the federal nor state cases are in conflict with the verdict of the jury or the judgment of the trial court as to the liability of Howard and his surety.

VII.

Neither the Congress of the United States nor the State Legislatures can constitutionally relieve public officials or quasi-public officials of the United States or the States from liability from the results of their negligence.

VIII.

The record discloses no error in the trial which is prejudicial to the defendants, or either of them.

Conclusion.

ARGUMENT.

I.

The Circuit Court erred in setting aside the judgment of the District Court based upon the verdict of the jury.

The majority of the Circuit Court of Appeals concluded its opinion as follows:

> "Howard's knowledge of the condition of the bank and his personal loans there, are to our mind facts immaterial in an action upon these bonds. They constitute no breach of the conditions. What their legal effect may be in an action against the Trustee personally, we are not called upon to decide." (R. 402.)

The implication of the foregoing is that in selecting a depository and placing and maintaining bankruptcy funds therein, a trustee or receiver in bankruptcy may be guilty of a lack of every care or precaution which a reasonably cautious man would exercise in the care of his own funds, that he may ignore obvious dangers to the funds caused by the unsound financial condition of the depository, runs thereon, loss of capital, bad management, or even the failing condition thereof. He may place bankruptcy funds therein because of corrupt agreements, motives of personal gain, or personal favors and may cause various depositories to bid for such funds by the promise of favors. He may, without regard to the strength of the depository, deposit therein bankruptcy funds many times the amount of the depository's bond. Yet, if bankruptcy funds are lost by reason thereof, he is not liable in such a manner as to charge the surety on his official bonds. Such a suggestion

is entirely new in the law of trusts, suretyship and bankruptcy.

In arriving at this conclusion, the Circuit Court ignored the fact that one of the duties of the trustee or receiver is to "deposit all money received," and that the only limitation on the place of deposit is that it must be "one of the designated depositories." (11 U. S. C. A. 75 (a) (3).)

The majority of the Circuit Court erroneously assumed that no discretion or duty of selection among designated depositories was vested in the trustee or receiver in depositing and maintaining deposits of estate moneys.

In August, 1930, when Howard made the original deposits in question, there were in Chicago twenty-one different banks that were qualified as depositories for bankrupt funds. (R. 112, 113.) At all times thereafter while Howard had estate moneys in the Phillip Bank, there were a substantial number of such depositories. The duty of the trustee or receiver being to deposit and keep such funds in a designated depository, Howard had the duty and discretion of selecting any one or more of the designated depositories to hold the funds of his estates. In placing and maintaining all of such funds in a single depository he could not ignore the knowledge which he had or should have had about such depository and which might affect the safety of money deposited and maintained therein by him as such trustee or receiver.

This duty of selection was solely Howard's. Each time that he made a deposit for any bankrupt estate, and at all times while he maintained such deposits, he was under obligation to exercise at least the degree of care which a reasonable man would use in depositing and maintaining deposits of his own funds if he were limited to banks that were designated depositories.

Howard voluntarily prejudiced his judgment and ability to perform his duty of selecting between designated depositories in the following manner:

Within one month prior to July 15, 1930, Clarence A. Beutel told Howard that he was about to become president of the Phillip Bank (R. 164) and requested Howard to make bankruptcy deposits therein. Discussion of this matter continued after Beutel became president of the Phillip Bank and included Bernard L. Rosset, Chairman of said bank. As a result, Howard, who had been depositing his bankruptcy funds in the Central Trust Company of Illinois and the Foreman Bank (R. 203, 255, 257), obtained an agreement from them that, in consideration of transferring and depositing his bankruptcy funds in the Phillip Bank, said Bank would make to Howard, personally, unsecured loans sufficient to pay unsecured loans which he then had with the Foreman Bank and the Central Trust Company, and, in addition, would give him further unsecured loans. (R. 257-8.) Thus, three things are evident,—first, that an agreement solely for his personal benefit was exacted by Howard for making and maintaining deposits, as trustee or receiver in bankruptcy, in the Phillip Bank after it became a designated depository; second, that Howard considered it necessary to have an agreement that loans would be made to him, before he felt free to take his bankruptcy funds out of one depository and place them in another; and, third, that he felt unable to remove the bankruptcy funds from the Central Trust Company and the Foreman Bank until he was able to pay the personal unsecured loans which he had therein. (R. 203, 257.) Subsequent larger borrowing and critical conditions in the Phillip Bank, where he thereafter made much larger deposits, necessarily greatly accentuate the mental limitations that he had when he transferred his bankruptcy funds thereto. (R. 77, 78, 203.)

There is no time or circumstances in which a person, occupying an official position of trust, can be justified either in absolute negligence or bad faith in performing an official duty, whether it be in the exercise of discretion in selecting between depositories, or otherwise.

Under the theory of the Circuit Court of Appeals, the designation of several depositories by the District Court permits a trustee or receiver maliciously to seek out the depository most likely to fail and to keep all of his estate moneys therein without any liability arising therefrom upon his official bond.

II.

Howard violated each of his official bonds.

The official bonds of Howard required (a) that he should obey such orders as the Court might make with relation to the trust; (b) that he should faithfully and truly account for all the moneys, assets and effects of the estate of each of said bankrupts which should come into his hands and possession; and (c) that he should, in all respects, faithfully perform all his official duties as trustee or receiver. (R. 59, 65.)

A. *Howard failed to obey the orders of the Court.*

Evidence was introduced that Judge Carpenter, on July 1, 1931, entered an order requiring *receivers* to report to the Court the amount of funds in all depositories. (R. 145.) No such report by Howard from June 9, 1931, until after June 21, 1932 (the date of closing of the Phillip Bank), was produced. Secondary evidence was given to indicate that something had been taken to the clerk's office from time to time. (R. 145, 153, 159, 184, 185, 187, 188, 204, 252, 277.) The jury

was entirely justified in believing that Howard had not made any such report of the amount on deposit in the bank, save to a deputy clerk, on June 9, 1931, and none pursuant to the Court's order. Hence, if the order of July 1, 1931, by Judge Carpenter was the character of an order contemplated in the statutory duties of Howard, there was no primary evidence that he ever made a report of the funds in all of his bankrupt estates during the entire time that the funds were in the Phillip Bank.

B. *Howard failed to account.*

The jury also was justified in believing that Howard had violated the provision of the bonds requiring him to "faithfully and truly account for all the moneys, assets, and effects of the estate * * * which shall come into his hands and possession, * * *." (R. 59, 65.)

In 1 C. J. S. 576, the author states:

> "The verb 'account' is frequently employed with 'for,' and the term 'account for,' has, in various adjudications, been interpreted to mean paying over the money to the person entitled thereto; hence more than merely filing an exhibit or statement of account." (Citing authorities.)

The question of the duty of a fiduciary is considered under such an expression in the bond in *Hale County, Texas* v. *American Indemnity Co.*, 63 F. (2d) 275, on page 279 (C. C. A.). See, also, *U. S.* v. *Rehwald, et al.*, 44 F. (2d) 663, and cases cited therein.

It was contemplated by the bonds that moneys would come into Howard's hands, both as trustee and receiver, and be accounted for. It was not accounting for money to place and keep it in a depository known to be on the verge of failure, or, in handling the funds which

came into his hands, to limit his power to act by making corrupt agreements or taking special favors.

Also, there was an unconscionable amount of money continually kept on deposit and Howard had the primary duty of distributing such money. (11 U. S. C. A. 75 (a) (2).) Howard had $416,833.90 of estate moneys on deposit in the Phillip Bank when it closed. (R. 72.) For example, $132,707.00 went on deposit on August 25, 1930, to the credit of the National Theatre Corporation (R. 73), and $52,174.17 still was on deposit to the credit of such account at the time the bank closed, with only a $1,000 bond. (R. 24.) Because of the delay in payments, if for no other reason, and the final loss because of such delay, there was not a faithful accounting. A delay in payment of dividends can be a breach of duty to account. (See Judge Evans' dissenting opinion herein. (R. 403.) See, also, *State* v. *McNamer,* 62 Mont. 490, 205 Pac. 951; *Amer. Surety Co.* v. *Public Schools,* 70 F. (2d) 653 (C. C. A. 6 C.); *Slope County* v. *Douglas,* 49 N. D. 1026, 194 N. W. 385.)

C. *Howard failed to perform his official duties.*

There was a breach of the provision of the bonds requiring Howard, as trustee or receiver, "to faithfully perform all his official duties as such officer." The occasion for requiring a depository bond is protection of the funds of bankrupt estates which are on deposit. (Gilbert's Collier on Bankruptcy, 2d Ed., Sec. 101 (b), page 929.) The bond required by statute was intended to protect the deposits. The condition of the bond of a trustee or receiver in bankruptcy is breached by the negligence, without corruption, of the principal in the performance of even a ministerial duty. (*U. S.* v. *Perkins,* 280 F. 546

(C. C. A.); *In re Hoyt, et al.*, 119 F. 987.) As is pointed out by Judge Evans, and as is shown in each bond, Howard occupied a trust or a fiduciary relationship. (R. 60, 65, 403.) (25 C. J., page 1118.) See also, *In re Lenters*, 225 F. 878, 883 (D. C. Pa.) and *Rodgers* v. *Bankers Nat. Bank*, 179 Minn. 197, 229 N. W. 90, 91.

It is a general rule that where, by statute, an official is required to deposit in a particular depository, this does not relieve such official from liability for malfeasance, misfeasance or non-feasance in the care of funds. (*Jordon* v. *Baker*, 252 Ky. 40, 66 S. W. (2d) 84, 93 A. L. R. 813; *Edwards* v. *Logan County*, 244 Ky. 296, 50 S. W. (2d) 83; *State* v. *McNamer*, 62 Mont. 490, 205 Pac. 951.) A public or quasi-public officer is liable for misconduct in the performance of his duties. (46 C. J., Sec. 398, page 1068, and Sec. 401, page 1069.) In fiduciary relationships involving trusts, a trustee or fiduciary may not place himself in a position in which his self interest will or may conflict with his duty as trustee. (65 C. J. 520, page 652; *Booth* v. *Greer Investment Co.*, 52 F. (2d) 857, 860 (D. C. Okla.); *Bennett* v. *Weber*, 323 Ill. 283, 294, 154 N. E. 105, 109.) Furthermore, a trustee or receiver must act in good faith and with ordinary prudence in making and maintaining deposits in a bank, otherwise he is liable for a loss occasioned by the failure of such bank. (53 C. J., Sec. 194, page 156; 65 C. J., Sec. 566, page 701, and Sec. 519, page 647; see, also, *Fidelity & Deposit Co.* v. *Redfield*, 7 F. (2d) 800 (C. C. A. 9th C.).) And every violation by a trustee whether wilful or neglectful is a breach of trust. (*Natl. Surety Co.* v. *State*, 152 Md. 71, 136 Atl. 274; *Thompson* v. *Hays*, 11 F. (2d) 244 (C. C. A. 8 C.).)

It will be observed that these principles apply to making and maintaining deposits, excessive or otherwise, to the several runs on the Phillip Bank, to the reduction in the

deposits, and to the various notices which came to Howard from the officers of the bank (R. 169-178, 192-196, 259-263), from publications (R. 83-101, 271) and other sources. (R. 117-118, 120, 123-128.) Notice of facts which would put a man of ordinary prudence on inquiry under similar circumstances will be construed as notice of all the facts which a reasonably diligent inquiry would disclose. This is a basic rule of trusts and applies equally to the handling of bankruptcy funds by a trustee or receiver in bankruptcy. (46 C. J., Sec. 28, page 543; *Essex National Bank* v. *Hurley,* 16 F. (2d) 427 (C. C. A. 1st C.); *Grandison* v. *National Bank of Commerce,* 231 F. 800, 809 (C. C. A. 2d C.); *Martin* v. *Federal Surety Co.,* 58 F. (2d) 79 (C. C. A. 8th C.); *Coder* v. *McPherson,* 152 F. 951 (C. C. A. 8th C.); *McClean* v. *Bradley,* 282 F. 1011, Aff. 299 F. 379 (C. C. A. 6th C.), Cert. Den. 266 U. S. 619, 69 L ed. 471.)

III.

The liability of his surety is coextensive with that of the Trustee or Receiver in Bankruptcy in respect of all losses resulting from official acts or omissions of such Trustee or Receiver.

A. *The surety company's liability.*

Because of the large number and amount of the bonds which it issued on Howard, 123 being involved in this case, the surety at all times had a knowledge that it was heavily involved in his bankruptcy transactions and that, to the extent of its bonds, it was contracting "to pay losses which might arise (1) from failure of Howard to obey an order of the Court; (2) from failure upon his part faithfully and truly to account for the moneys of the estates; and (3) from failure by him faithfully to perform 'his official duties as said trustee.'" (R. 5, 396.)

It is stated in 46 C. J., Sec. 398, page 1068, that:

> "Where an officer, acting in a matter in which he is authorized to act, is guilty of official misconduct, he is not faithfully performing his official duties, and he and his surety are liable on his official bond for resultant damages. The condition of an official bond providing for the faithful discharge by the principal of his official duties is broken by the mere negligence, without corruption, of the principal in the performance of a ministerial duty, which performance does not involve the exercise of discretion."

And, of course, it follows that any act which, if done genuinely and honestly by an officer would be an official act, is, if done negligently and recklessly, an act done by virtue of his office and the sureties on his bond conditioned for the faithful discharge of the duties of his office are liable for injuries resulting therefrom.

See, also:

National Bank of Redemption v. *Rutledge*, (C. C.) 84 F. 400.

There is no limitation in the bonds as to the manner in which the duties of the officer should be performed. (R. 59, 65.) It follows, therefore, that the surety is liable for losses caused by Howard's negligence, to the full extent of the bonds that were issued to secure the faithful performance of his official duties.

B. *The opinion of the Circuit Court.*

A number of Courts have adopted a distinction between acts which are *virtute officii*, that is where the breach occurs in a matter connected with the actual duties of the office, and those which are *colore officii*, and have stated that sureties may not always be liable for breaches of duties or money lost where the acts are merely *colore officii*. The

definition of the terms is given in 67 C. J., page 255. In 11 C. J., page 1225, note 13, there is a discussion of these two phrases and an indication that it is quite rare that, where a negligent act is done within the scope of official authority, the sureties can escape liability by stating that the act was merely done *colore officii*, and to the same effect is 22 R. C. L., Sec. 190, page 507, note 2, and 46 C. J., Sec. 401, page 1069.

In the majority opinion in this case, the Circuit Court stated (R. 398), in referring to the surety on a bond:

> "He does not consent to become liable for *any* act in which the officer may become engaged in the pursuit of his office. Otherwise stated, an officer may so act as to render himself personally liable as a matter of general law, but it does not follow necessarily that his official bondsmen are liable. The liability of sureties is limited to that for breach of official duties of the principal, and does not include an undertaking against every act that the official may perform or every failure to act of which he may be guilty." (Italics ours.)

In making the above statement, the majority of the Circuit Court has adopted the minority rule as to sureties' liability on bonds.

The Circuit Court cited the case of *Lowe* v. *City of Guthrie*, 4 Okla. 287, 44 Pac. 198, as authority for the proposition that the liability of a surety is not necessarily co-extensive with that of his principal. In that case when referring to the duties of a city clerk, the Court therein stated:

> "mere officiousness of the clerk in the assumption of duties not belonging to his office, or the negligence of other officers in the discharge of their duties, cannot extend to the sureties' liabilities beyond the term of their undertaking. (*People* v. *Pennock*, 60 N. Y. 421; *Supervisors* v. *Bates*, 17 N. Y. 242.)"

In the instant case, Howard's violations of his bonds were solely in performing the duties of his office and no other officer was involved. It was Howard's responsibility to select the depository among those which had been designated by the District Court, and to deposit his estate funds in such designated depositories as he might select. (11 U. S. C. A. 75 (a) (3).) It was Howard who arranged to receive personal loans in consideration of placing his estate funds in the Phillip Bank and by such action destroyed his ability, then or thereafter, to properly appraise its soundness or to act pursuant to the information which he had regarding said Bank. (R. 258.) *Each of these acts was done by Howard virtute officii and, accordingly, the case cited is in no way parallel to the situation here involved.*

The following cases (R. 398) also were cited by the Circuit Court as authority for the proposition that Howard could be liable without subjecting his surety to a like liability:

City of Salisbury v. *Lyerly,* 208 N. C. 386, 180 S. E. 701: This case held that a shortage on a bond as treasurer of a city would not make the bondsman liable for a shortage of the same person as tax collector; *District of Columbia* v. *Petty,* 229 U. S. 593, 57 L. ed. 1343, held that a bond as auditor would not make the bondsman liable for the defalcation of a disbursing clerk who was responsible to the District of Columbia Commissioners; *Orton* v. *City of Lincoln,* 156 Ill. 499, 41 N. E. 159, held that a bond on the city clerk making him responsible for all money that should come into his hands by virtue of his office would not make the bondsman liable for money that was collected by the city clerk which should have been collected by the city treasurer, as was also the case in *Lowe* v. *City of Guthrie,* 4 Okla. 287, 44 Pac. 198, *supra; Campbell* v. *American Bonding Company,* 172 Ala. 458, 55 So. 306, held that sure-

ties on the official bond of the executor of an estate are only liable for assets which belong to the estate of which he is executor; *Wilkes Barre* v. *Rockafellow,* 171 Pa. 177, 33 Atl. 269, 270, held that the sureties on the bond of the city treasurer are not liable for the loss of the sinking fund of the city which was under the control of sinking fund commissioners and lent by them to the person who was the city treasurer.

It is apparent that in all of the above cases the surety was relieved from liability because the liability of the principal arose out of acts not connected with his office. Such was not the situation in the instant case and, therefore, these citations have no application here.

Nor can we understand why the Circuit Court cited the case of *City of Parsons* v. *Fidelity & Deposit Co.,* 29 F. (2d) 417, for on appeal said case was reversed, 43 F. (2d) 315 (C. C. A. 10 C.), and the surety was held liable.

None of the cases cited is an authority for relieving either Howard or his surety from liability, in the present situation, and on the contrary, show that the underlying theory on which sureties are held liable, applies to the instant situation. Here there was not only gross negligence in the performance of official duties, but a contract with the depository which might readily be called corrupt. The leading case in the Federal Court on the effect of negligence of trustees in bankruptcy is *United States* v. *Perkins,* 280 F. 546 (C. C. A. 8th C.), where the Court said, page 549:

> "Sureties on official bonds are liable for negligence or malfeasance of their principal in the performance of acts which are done *virtute officii. The bond providing only for the faithful discharge of the principal of his official duties, the condition of the bond is considered to have been broken by the mere negligence, without corruption, of the principal in the performance of a ministerial duty, which performance does involve the*

> *exercise of discretion, and, where the duty which has not been faithfully discharged was owing to the person injured, such person may sue on the bond.* By the weight of authority, acts done by color of office are regarded as acts for which sureties on official are liable. 29 Cyc. 1455, 1456, and cases cited." (Italics ours.)

In the foregoing case, which involved the breach of a bond of a trustee in bankruptcy, the court held the sureties liable for acts of a fraudulent nature when done merely under color of office.

In the instant case, the Circuit Court, in referring to the bonds, correctly states:

> "The instrument is required by a statute which defines its terms, and the law of the office is a part of the contract. The surety guarantees the faithful discharge of all duties properly pertaining to the office, and the extent of such liability can be determined only from the bond and from the statutes creating the office and defining the terms of the bond." (R. 398.)

For the violation of his official duties, as herein set forth, Howard's sureties are undoubtedly liable.

We agree with the statement of the Circuit Court: "If he has authority to select the depository, and no other body has any power of such selection, he is not relieved." (Citing *State* v. *Bobleter,* 83 Minn. 479, 86 N. W. 461.) (R. 400.) There is an intimation by the Court, however, that Howard had no power of selection, whereas it is an undisput d fact that at all times he had numerous qualified depositories to choose between. (R. 112.)

The statement of the Circuit Court: "Nor is the size of the bond a warning to him of the amount he may deposit in a depository" (R. 400) is not supported by the

only cases cited by that Court in support of this proposition:

City of Billings v. *Mass. Bonding & Insurance Co.*, 88 Mont. 91, 290 Pac. 246. In this case the city treasurer, whose sureties were sued, was expressly exempted by statute from liability for loss of funds in the depository.

Illinois Surety Company v. *U. S.*, 226 F. 665. The language (R. 400) quoted from this case without the context gives an entirely erroneous impression. The suit was on a depository bond and the query that arose was whether all depositors should share alike in the proceeds thereof or be paid in the order of the deposit in the bank by the various receivers and trustees. The question, answered by the language quoted from page 667, was whether each depositor, before he made his deposit, must ascertain whether his deposit would cause the total sums of deposits to exceed the depository bond. The question of liability of the trustee or receiver for depositing amounts in excess of the depository bond was not before the Court.

Whether "designated depositories" are "officers of the court" (R. 400) is not of importance in the instant case. In a few States bonds are given directly to States or municipalities, usually where bids are taken for the right to become depositories, and the officials collecting the money and making deposits are mere ministerial officers without any possible personal liability save for their negligence in handling the funds prior to the time of making the deposits and having no responsibility in the selection of the depository. Such depositories are called "quasi public officers." Apparently the Circuit Court of Appeals in the *Illinois Surety Company* case, *supra*, did not so consider the depository in bankruptcy. It said, page 668:

> "That the possible beneficiaries of the depository's bond are a limited class, the depositors, and that the

bond is perhaps not, strictly speaking, an official bond, afford no basis for differentiating it from a trustee's or referee's bond. The United States is no more an active trustee for the depositors than for the general public."

The Circuit Court, however, in the instant case then proceeded to discuss the case of *Town of Hamden* v. *American Surety Company,* (D. C.), 9 F. Supp. 733, 738, *supra,* and quoted language from that decision which referred only to the Federal depository system for public officials and has no relationship whatever to the method of making deposits in bankruptcy matters.

We have not discussed all of the cases cited or referred to in the majority opinion of the Circuit Court of Appeals, but not one of them is authority for the decision of the Circuit Court in the instant case.

C. *The Federal rule as to the liability of sureties on official bonds.*

If trustees and receivers in bankruptcy are to be treated in the same category as public officials of the United States, the Federal rules as to the liability of sureties on public officials' bonds would apply and the various decisions of the several States would be of little value in determining the questions involved in this case. The earlier opinions of the Supreme Court of the United States held that where an official executed a bond "to faithfully execute all of the duties of his office," and the duties of such office required the collection and payment into the United States Treasury of public funds, his surety was liable for the payment of such funds into such treasury, and that if such money was stolen or destroyed without fault of the public official or lost in any way except by act of God, the bondsmen were liable.

The leading case supporting the so-called insurance rule is *United States* v. *Prescott,* 3 How. 578, 11 L. ed. 734, 738. This was followed by *United States* v. *Morgan,* 11 How. 154, 13 L. ed. 643; *United States* v. *Dashiell,* 4 Wall, 182, 18 L. ed. 319, 321; *United States* v. *Keehler,* 9 Wall. 83, 19 L. ed. 574, and *Boyden* v. *United States,* 13 Wall, 17, 20 L. ed. 527. Such cases involved receivers of public moneys, collectors of ports and postmasters.

Although the Supreme Court previously had held, in *Bevans, Receiver* v. *United States,* 13 Wall. 56, 20 L. ed. 531, that the receiver of public money was liable for money seized by the Confederate Government, the Court reconsidered the entire subject in *United States* v. *Thomas,* 15 Wall. 337, 21 L. ed. 89. Thomas was Surveyor of Customs at Nashville, Tennessee, and the money involved was seized by the Confederate Government. The Court called attention to the strict rules as to receivers of public moneys, as laid down in the foregoing cases, and finally stated on page 92:

> "Still they are nothing but bailees. To call them anything else, when they are expressly forbidden to touch or use the public money except as directed, would be an abuse of terms. But they are special bailees, subject to special obligations. It is evident that the ordinary law of bailment cannot be invoked to determine the degree of their responsibility. This is placed on a new basis. To the extent of the amount of their official bonds, it is fixed by special contract; and the policy of the law as to their general responsibility for amounts not covered by such bonds may be fairly presumed to be the same."

And later after examining a number of cases, including the *Prescott* case, the Court summarized on page 93:

> "It is unnecessary to examine the cases further in detail. It appears from them all (except, perhaps, the New York case) that the official bond is regarded

> as laying the foundation of a more stringent responsibility upon collectors and receivers of public moneys. It is referred to as a special contract, by which they assume additional obligations with regard to the safe keeping and payment of those moneys, and as an indication of the policy of the law with regard to the nature of their responsibility."

The Court in the above case held that the taking of the money by the Confederate Government was an act of "over-ruling necessity" which might be classified with acts of God and which rendered the sureties not liable, but in effect restated the insurance doctrine theretofore laid down.

As late as *Smythe* v. *United States,* 188 U. S. 156, 47 L. ed. 425, the superintendent of the mint of the United States in New Orleans was held personally responsible on his bond for the destruction by fire of public money in his custody, including interest on such money. All of these matters were considered in *Town of Hamden* v. *American Surety Company,* 9 F. Supp. 733. Subsequent to these decisions the Federal Government adopted a policy of requiring officials to deposit public funds with the Treasurer of the United States or a depository thereof, such depository to be designated in conformity with 31 U. S. C. A., Sec. 476, which statute with 12 U. S. C. A., Secs. 391, 392, authorized the secretary of the treasury to designate any of the Federal Reserve Banks as depositories. As the Circuit Court of Appeals said in its opinion in the instant case:

> Such funds "'when once deposited with a duly designated depository of the United States, are in effect in the treasury of the United States and hence no longer in the possession or custody of that receiving officer.'" (R. 401.)

All of this language, however, in connection with the instant case has no relation to the depository system as laid down by the statutes relating to the Bankruptcy Depository System, save that they may be taken as indicating the policy of the Federal Government with reference to sureties on bonds prescribed by statutory enactment and showing the strict responsibility which always has been, and now is, placed upon such sureties upon their entering into such bonds.

The statute relative to trustees in bankruptcy provides, in U. S. C. A., Title 11, Sec. 78 (b):

> "Trustees, before entering upon the performance of their official duties, and within ten days after their appointment, or within such further time, not to exceed five days, as the court may permit, shall respectively qualify by entering into bond to the United States, with such sureties as shall be approved by the courts, conditioned for the faithful performance of their official duties."

The actual form of the bonds has been adopted by the Supreme Court of the United States pursuant to U. S. C. A. 11, Sec. 53, as Form No. XXV. It is agreed by the parties hereto that the bonds of the receiver and the trustee are of the same legal effect. Thus, both the giving and the form of the bond are provided by statute. The depositories of bankruptcy funds are designated under Sec. 101 of Title 11 and are required to give bonds to the United States, and it also provided that the District Court may:

> "* * * increase the number of depositories or the amount of any bond or change such depositories."

In *Huttig Mfg. Co.* v. *Edwards,* (C. C. A.), 160 F. 619, the Court said, page 622:

> "Section 61 of the bankruptcy act, makes it the duty of courts of bankruptcy to designate by order bank-

ing institutions as depositories of funds of bankrupt estates, and to require of them bonds *for the safe-keeping and forthcoming thereof.*" (Italics ours.)

In the instant case the depository bond has been paid in full and the amount of the judgment in the trial court was for the loss in excess of the depository bond covered by the bonds of Howard as trustee or receiver. The title to the property of the bankrupt vests in the trustee. (U. S. C. A., Title 11, Sec. 110.) The Court submitted the case to the jury on the theory that Howard was liable as a bailee and not that the surety on the bonds was liable for any excess of deposits beyond the depository bond under the general Federal rule of strict liability. (R. 297.) Presumably, however, we also may assume that under the Federal decisions, Howard is of the character of "special" bailees referred to in *United States* v. *Thomas,* 15 Wall. 337, 21 L. ed. 89, *supra.* In making the arrangements for transferring the funds from the Central Trust Company and the Foreman Bank and in all of his subsequent official transactions with the Phillip Bank, Howard was acting within the scope of his duties as trustee or receiver in bankruptcy. (R. 166, 192, 203, 259.) If in so acting he was negligent, reckless or corrupt, he violated his bond and his surety was liable for loss occasioned by such violation.

Howard offered to prove on trial that a portion of the money which was loaned to him was actually used in the conduct of the bankrupt estates. (R. 206-17, 254.) He did show that as a consideration for depositing the money in the Phillip Bank there was an agreement that he should be paid enough money to repay his loans at the Central Trust Company and the Foreman Bank. (R. 258.) The evidence was that he received more than enough money at once to make such payments and that there was

an agreement that he should also receive additional money as he desired it, and he received such additional money. (R. 258.) If this in any way hampered or fettered him in the performance of his official duties or, by affecting his judgment, caused him to be negligent with resultant loss to his estates, his surety was liable.

The loss resulting from his failing to act upon his knowledge of four runs upon the bank in 1931, of decreased deposits, of reduced assets, and of the fact that such runs normally cause the more readily convertible assets to be decreased, was the result of negligence and chargeable to him and his surety. If, in fact, the original contract to place his money in such bank was corrupt and led to the loss of his bankruptcy funds through the failure of the bank, then the surety is liable.

IV.

Negligence, or a failure to exercise ordinary care in the performance of a statutory duty, entering into corrupt agreements, accepting personal favors, or accepting compensation other than as allowed by law are violations of the official bond of a Trustee or Receiver in Bankruptcy.

As an officer of the Court, Howard was not in the same situation as a statutory federal official who collects taxes or public funds. The trustee has title to the funds of the bankrupt estates and the funds in the possession of both the trustee and receiver belonging to bankrupt estates are private funds as distinguished from public funds. (*Florida Bank and Trust Company* v. *Union Indemnity Co.*, 55 F. (2d) 640 (C. C. A.); *American Surety Company of New York* v. *Akron Savings Bank Company*,

74 Ohio St. 465, Aff. 212 U. S. 557, 53 L. ed. 651; *Lamb* v. *Townshend,* 71 F. (2d) 590, 592 (C. C. A. 4th C.); *Frank* v. *Salm,* 75 F. (2d) 747, 748 (C. C. A. 7th C.).) Such funds are deposited in the depository in the name of the trustee. (11 U. S. C. A. 75 (a) (3), and 110.)

In his dissenting opinion, in referring to Howard's responsibilities, Judge Evans said:

> "In other words, a trustee is one who occupies a fiduciary relation towards the creditors of the bankrupt. His is a position of trust. When the trustee, Howard, arranged with the bank to get a personal loan for a substantial sum and in return agreed to deposit the moneys which belonged to the creditors of the various estates for which he was trustee in the bank that loaned him personally the money, he failed in his plain duty to the creditors. He could not avoid the consequences of that failure if loss resulted through a failure of the bank, by showing that the bank wherein the money was deposited was a bank of deposit." (R. 403.)

In re Singer Furniture Corporation, 47 F. (2d) 780, 784, also held that the trustee or receiver occupies a fiduciary relationship. (See, also, page 21 hereof.)

In addition to incurring liability for negligence, as heretofore shown, Howard subjected himself and his surety to liability by depositing the money of his estates in the Phillip Bank pursuant to a corrupt agreement made with the officers thereof.

Black's Law Dictionary, second edition, defines "corruption" as follows:

> "Illegality; a vicious and fraudulent intention to evade the prohibitions of the law.
> *"The act of an official or fiduciary person who unlawfully and wrongfully uses his station or character to procure some benefit for himself or for another person, contrary to duty and the rights of others." Citing cases.* (Italics ours.)

Bouvier's Law Dictionary defines "corruption" as:

> "An act done with an intent to give some advantage inconsistent with official duty and the rights of others."

In addition to the other violations of his official bonds, Howard used his office and the funds of his estates to obtain financial benefits neither contemplated nor permitted to him by law, by receiving, in effect, portions of his compensation as trustee and receiver prior to the time the law permitted him to do so. (R. 255-9.)

The Circuit Court cites certain cases as to the necessity of placing bankruptcy funds in designated depositories. (R. 400.) None are cited, however, which hold or even imply that a trustee or receiver in bankruptcy may ignore his knowledge of dangerous conditions when using one depository from among many, or that he may limit his freedom of action as trustee or receiver by placing himself under personal obligation. Obviously, where the statute requires an official to place his funds in a certain class of depository, and gives him the right to select between several within such class, the very selection is in itself a discretionary duty, in the exercise of which he is liable for negligence or bad faith.

The ordinary rule goes beyond the statements above made. Where a bond is given to secure moneys to be deposited in a designated depository, if the officer having charge of making the deposits places larger sums in the depository than the amount of the depository bond, under the apparent protection of such bond, such officer and his surety ordinarily are held liable as insurers for any excess beyond the amount of the depository bond. (*State* v. *U. S. Fidelity & Guar. Co.*, 210 Wis. 178, 246 N. W. 434, 436; *Roberts County* v. *Wickard*, 53 S. D. 511, 221

N. W. 246; *State* v. *Carney*, 208 Ia. 133, 217 N. W. 472; *Mass. Bonding & Ins. Co.* v. *Steele*, 125 Neb. 7, 248 N. W. 648; *Board of Comrs. of Grant Co.* v. *Soucek*, 128 Okla. 151, 261 Pac. 947, 949; *Anderson* v. *Peterson State Bank*, 191 Minn. 404, 408, 254 N. W. 459, 461; *Cheyenne* v. *Maryland Casualty Co.*, 13 F. (2d) 401 (D. C. Wyo.).) In other words, the protection that is given to the depositing officer is only to the amount of the penalty of the depository bond.

Howard's duty as a trustee or receiver in depositing and maintaining bankruptcy funds, was at least that of ordinary care. No decisions where an official and his surety are relieved from liability for negligence in the management of private funds committed to his care, have been shown.

In *Magruder* v. *Drury*, 235 U. S. 106, 59 L. ed. 151, at page 156, the Court stated:

> "It is a well settled rule that a trustee can make no profit out of his trust. The rule in such cases springs from his duty to protect the interests of the estate, and not to permit his personal interest to in any wise conflict with his duty in that respect. The intention is to provide against any possible selfish interest exercising an influence which can interfere with the faithful discharge of the duty which is owing in a fiduciary capacity."

The above case follows *Michoud* v. *Girod*, 4 How. 503, 11 L. ed. 1076, wherein the Court stated, at page 1099:

> "The general rule stands upon our great moral obligation to refrain from placing ourselves in relations which ordinarily excite a conflict between self-interest and integrity. It restrains all agents, public and private; * * * it acts not on the possibility that, in some cases, the sense of that duty may prevail over the motives of self-interest, but it provides against the probability in many cases, and the danger

> in all cases, that the dictates of self-interest will exercise a predominant influence, and supersede that of duty."

These cases reflect the law which has been settled in this Court since 1846.

The liability of an officer for corruption exists whether or not the corrupt agreements are advantageous to such officer. However, in the instant case, such agreements did inure to the personal financial advantage of Howard at the expense of his estates. The estate moneys were removed from large centrally located Chicago depositories and placed in the Phillip Bank, a small outlying depository, pursuant to and in consideration of an agreement that the Phillip Bank would loan money to Howard as an individual upon his personal unsecured note, and there apparently was at least a tacit agreement that the deposits in the Phillip Bank would be increased as additional money was received by said estates or as Howard became trustee or receiver for other estates, or at least such was the result. (R. 72, 74.) The evidence clearly indicates that Howard could not obtain these personal unsecured loans from the Phillip Bank without transferring his estate moneys to such bank (R. 258), and it also appears probable that he could not have continued to maintain and increase these loans at such bank unless said deposits also were maintained.

Accordingly, Howard used his power over the estates to obtain a financial benefit other than the commissions to which he might have been entitled by law, by using the funds of the estates in the nature of security to enable him to obtain presently a portion of the commissions to which he anticipated that he would ultimately be entitled. These anticipated commissions were care-

fully estimated in connection with determining the amount of the loans to Howard. (R. 165, 258.) The power to borrow money has a definite and ascertainable present value and price. (See 65 C. J., Sec. 520, page 662.)

V.

The public fund depository system (31 U. S. C. A. Sec. 476) and the plan provided in Section 47 of the Bankruptcy Act (11 U. S. C. A. Sec. 75) and Section 61 of the Bankruptcy Act (11 U. S. C. A. Sec. 101) have no direct relationship to each other.

The opinion of the Circuit Court fails to distinguish between the depository system provided for public funds belonging to the United States and depositories provided for the receipt of bankruptcy funds under Sections 47 and 61 of the Bankruptcy Act, as we heretofore have shown. (Page 31 herein.) Funds deposited by tax collecting officers, when deposited in federal reserve banks in accordance with the statute, are assumed to be in the custody and possession of the United States, whereas bankruptcy funds, although required to be deposited in designated depositories, are private moneys, and title remains in the trustee. The failure of the Circuit Court to recognize this distinction in the instant case is apparent in that the Court discussed depositories which were officers, referring primarily in such discussion to State cases, and then discussed the case of *Town of Hamden* v. *American Surety Company*, 9 F. Supp. 733, *supra*, and quoted therefrom. The Court in that case had before it an action by a town against the surety on the official bond of the town treasurer involving a liability of a custodian of public funds in the State of Connecticut. The Court discussed the entire Federal and State system

of the deposit of public funds, but did not at any time consider the question of the deposit of the funds of bankrupt estates. The language quoted therefrom by the Circuit Court, in the instant case (R. 401), was solely with reference to public funds of the United States coming into the possession of the United States when deposited in a public depository of the United States.

Accordingly, in so far as the decision of the Circuit Court is based upon the language of that case and of the State cases therein referred to, such decision necessarily is erroneous. The Circuit Court did not quote that portion of the Town of Hamden case where the Court said, page 738:

> "The policy of these statutes and the unqualified undertakings of official bonds given in conformity therewith, the Supreme Court has indeed declined to relax."

VI.

Neither the federal nor state cases are in conflict with the verdict of the jury or the judgment of the trial court as to the liability of Howard and his surety.

The question of liability on bonds of public officers under the Federal decisions heretofore has been discussed. (Page 29 herein.) The entire subject is considered in great detail in a note in 93 A. L. R. on page 819, where the author states:

> "Upon the general question there exists an irreconcilable conflict of opinion. The weight of authority, numerically at least, adheres to a doctrine of strict liability, holding that such an officer is not to be exonerated by any consideration of honesty, diligence, and faithfulness in the case of the loss of public money while in his hands, unless the loss shall have

been occasioned by the act of God or the public enemy."

In *Town of Hamden* v. *American Surety Co.*, 9 F. Supp. 733, *supra*, heretofore referred to (pages 29, 31, 39 herein), the Court, in its elaborate consideration of the general subject, after indicating that as to the question of sureties on State officials Federal authorities would give little assistance, stated, page 738:

> "Indeed, the liability of a state official, as well as the construction of his official bond, is a matter of local law as distinguished from one of general jurisprudence. *Bassinger* v. *U. S. Fidelity & Guaranty Co.* (C. C. A.) 58 F. (2d) 573, certiorari denied 287 U. S. 622, 53 S. Ct. 21, 77 L. ed. 540. Necessarily the liability of such an official will depend on state statutes, if such exist; and in the absence of statute, on the common law of the state which in large measure must be deduced from the administrative system of the state."

A great number of State decisions were cited in the brief of respondents herein in opposition to the petition for a writ of certiorari (pages 13-20), in an attempt to lay down fundamental rules with reference to the liability of sureties on official bonds. Such decisions are not authority in the instant case.

The note in 93 A. L. R. 819 emphasizes the fact that, until this Court has decided this case, the most direct authorities on the subject are those cases which consider the negligent or improper management of trust funds, particularly those having to do with deposits in banks. Beyond the amount of the depository bonds, there is no protection to bankruptcy deposits save the size and strength of the bank in which the money is deposited. The whole history of surety bonds, in so far as the Federal Government is concerned, shows an adherence

to the doctrine of strict liability for funds committed to the care of officers unless qualified by statute, and there are no cases, either in Federal or State courts, which indicate that where funds of a fiduciary are lost due to negligence, particularly where deposits of such lost funds are made pursuant to a corrupt agreement, the depositing officer and his surety can be absolved from responsibility therefor.

This is particularly illustrated in a note in 38 A. L. R. referring to loss of public funds, where the author, citing many cases, said, page 1513:

> "A majority of the courts hold that an act of the legislature designed to relieve a public officer or his surety from liability for the loss of public funds, *occurring without the fault of the officer,* is constitutional; * * *." (Italics ours.)

It thus appears that the power of the Legislature to relieve from liability for the loss of public funds is only where such loss occurs *without the fault of the officer.*

VII.

Neither the Congress of the United States nor the State Legislatures can constitutionally relieve public officials or quasi-public officials of the United States or the States from liability from the results of their negligence.

This question arises because of the opinion of the Circuit Court in the instant case stating that the mere deposit of bankruptcy funds in a designated depository was a complete exoneration of the depositing trustee or receiver without regard to his negligence or lack of good faith in making and maintaining such deposits.

There is some basis for the State or Federal Govern-

ment to grant relief to public officials and their sureties from the rigorous rule of insurance of public funds committed to their possession, in times of great stress and where no negligence or malfeasance is shown in the management of the funds of such officials, as in *Schenebeck* v. *McCrary, et al.*, 298 U. S. 36, 80 L. ed. 1031. However, there is no case where the State or Federal Government has released a public officer or his surety from liability for loss resulting from direct negligence or malfeasance in the making or maintaining of deposits of public funds when he has any power of selection between depositories. This is shown in the note in 38 A. L. R. 1513, heretofore referred to.

The power of the Congress or the Legislature to relieve an officer, if such exists, applies only to *public* funds and then only when the public officer was not at fault. In the instant case *private* funds were involved. The fault of the officer, Howard, was shown, and the bonds were conditioned upon the faithful performance of "all of his official duties" as trustee or receiver.

To deny the right to recover for loss resulting from the negligence or misconduct of the trustee or receiver herein would be a deprivation of property without due process of law in violation of the 5th Amendment to the Constitution of the United States.

In 2 Cooley on Const. Lim. (8th Ed.), it is said on page 756:

> "But a vested right of action is property in the same sense in which tangible things are property, and is equally protected against arbitrary interference. Where it springs from contract, or from the principles of the common law, it is not competent for the legislature to take it away."

In *Angle* v. *Chicago, St. P. M. & O. R. Co.*, 151 U. S. 1, 38 L. Ed. 55, it is said on page 65:

> "An executive may pardon and thus relieve a wrongdoer from the punishment the public exacts for the wrong, but neither executive nor legislature can pardon a private wrong or relieve the wrongdoer from civil liability to the individual he has wronged."
>
> *Muir* v. *L. & N. Ry. Co.*, 247 F. 888, 897.
>
> 12 C. J., Sec. 551, page 972.
>
> Black, Const. Law, 3rd Ed., page 602.

Every creditor in each of the 123 cases here involved was wronged by Howard's improper conduct as trustee and receiver.

VIII.

The record discloses no error in the trial which is prejudicial to the defendants, or either of them.

The opinion of the Circuit Court does not deal with the incidents of the trial. Nor did the brief of respondents in opposition to the petition for certiorari in this case discuss such incidents or the instructions of the jury, except to state that, "Petitioners have not discussed these other questions and respondents, reserving all rights, have likewise not done so." (Respondents' Brief, page 30.) In view of this statement, we desire to refer briefly to the objections that were made on the trial, and to the assignments of error. We believe, however, that because of the theory upon which the liability of Howard and his surety was established, the objections and assignments of error of the respondents are entirely without merit.

Respondents made eighty-four assignments of error,

occupying thirty-three pages of the record (R. 313-347). It is impossible to deal with them in detail in a brief of reasonable length. This Court has censured such method of assigning error as a mere encumbering of the record. (*Central Vermont Railway Co.* v. *White,* 238 U. S. 507, 59 L. Ed. 1433; *Local 167, I. B. T. etc.* v. *United States,* 291 U. S. 293, 296, 78 L. Ed. 804, 808; *Phillips, etc. Construction Co.* v. *Seymour,* 91 U. S. 646, 648, 23 L. Ed. 341.)

The defendants in the District Court received a fair trial. None of the material evidence offered and admitted on behalf of the plaintiff was disputed, nor was any evidence offered in defense or contradiction thereof. The details of the contract between Howard and the officials of the Phillip Bank (R. 163-8, 191-2, 254-9), under which the funds were transferred from the large centrally located banks into the Phillip Bank, were amplified and fully admitted by the parties thereto and the story of the runs on the bank was made definite by them. (R. 169-78, 192-6, 259-62.) Testimony as to the size, strength, financial condition and all other details regarding the Phillip Bank was suitable and necessary evidence. Howard's deposits in the bank for the various estates was admitted. (R. 72.)

Howard's defense as to the safety of the funds was that the Central Republic Bank and its predecessor, the Central Trust Company, was behind the Phillip Bank and that such bank would protect his deposits (R. 262-3), and even though such action on the part of the Central Republic Bank was legally impossible, the representations in that respect are in evidence.

The defense was not a denial of such facts or a claim that Howard was not negligent in depositing the amount of money that he did. It was that any bank named as a de-

pository was entitled to be the recipient of any amount of deposits, and that the question of the bank's weakness or the reason for the deposits in such bank was not material. In fact there was an attempt to show that the judges of the District Court were solely responsible for the funds although such funds were in the name of Howard. (R. 173, 264.)

It is not strange that the judge, when one of the bankers stated that there was a practice in this territory of loaning money on personal unsecured notes to trustees and receivers based on the amount that they might possibly receive in fees from their estates in the future, expressed himself as surprised. (R. 166-8.) This, however, was the judge's prerogative if he saw fit. It made no difference with regard to Howard's liability whether other receivers had been negligent or not or even whether the Court had fully performed its duties. Testimony as to conversations between the judge and assistant clerks of the Court, and private conversations between Howard and the judge, if he had any, were properly refused. The particular judge was not called to the witness stand, nor his deposition taken, and even that probably would not have been competent, as the proof of judicial action is the record of the Court and no record was shown proving or tending to prove that Howard had complied with the order of July 1, 1931, relative to making a report, until 1933 and such record was not competent as the bank closed in June, 1932.

The Court had the right to comment on the evidence. (14 R. C. L., Sec. 15, page 743; *Vicksburg and Meridian Railroad Company* v. *Putnam,* 118 U. S. 545, 30 L. Ed. 257, 258; *Rucker* v. *Wheeler,* 127 U. S. 85, 32 L. Ed. 102, 106; *Lovejoy* v. *U. S.,* 128 U. S. 171, 32 L. Ed. 389; *Nudd* v. *Burrows,* 91 U. S. 426, 23 L. Ed. 286; *California Ins.*

Co. v. *Union Compress Co.*, 133 U. S. 387, 33 L. Ed. 730; *Horning* v. *District of Columbia*, 254 U. S. 135, 65 L. Ed. 185.)

The charge to the jury from one standpoint was more favorable than Howard was entitled to have. The Court submitted the case on the bailee theory, and the jury was allowed to determine the question of his liability on the evidence of negligence and of the violations of his official duty. (R. 294-300.) In view of the fact that all of the money sued for was the losses of fiduciaries in excess of the depository bond, the Court might well have given a peremptory instruction. The Court properly limited the argument to the facts in evidence.

If there was no negligence or malfeasance in the conduct of Howard's office and if the occurrences which were introduced in evidence could not be construed as a breach of the official duties of Howard; if trustees and receivers in bankruptcy may, with impunity, close their eyes and deposit in banks fiduciary funds many times the amount of the depository bonds and ignore occurrences which point inevitably to the failure of the depository; if, regardless of the liability of their principals, sureties have no liability on official bonds; then the minute care with which the assignments of error were prepared, the great number of them and the objections raised are important—otherwise they are inconsequential and the points raised could have no possible effect were the case to be tried over again.

The various rules in this regard are as follows:

There was no error in the admission of evidence, but it has been frequently held that the admission of incompetent evidence to prove a fact that was fully proved by other competent evidence was not ground for reversal. (U. S. C. A., Title 28, Section 391, page 443, note 203,

and page 416, note 121, and cases cited. *Portland Gold Mining Co.* v. *Flaherty,* 111 F. 312, 319 (C. C. A. 8 C.); *St. Louis & S. F. R. Co.* v. *Duke,* 192 F. 306, 309 (C. C. A. 8. C.); *South Memphis Land Co.* v. *McLean Hardwood Lumber Co.,* 210 F. 257, 260 (C. C. A. 6 C.).)

The burden of showing prejudicial error is upon the defendant in the trial court and he is not entitled to a reversal unless it appears that he was denied some substantial right, thereby prevented from having a fair trial. (U. S. C. A. Title 28, Section 391; *Camp* v. *Gress,* 250 U. S. 308, 63 L. Ed. 997, 1004; *Fidelity & Casualty Co.* v. *Glenn,* 3 F. (2nd) 913, 918 (C. C. A. 4 C.); *Monument Pottery Co.* v. *Imperial Coal Corporation,* 21 F. (2d) 683, 685 (C. C. A. 3 C.).)

The verdict and judgment were in such form that by simple mathematical calculation the amounts of the judgment in favor of each of the separate estates could be shown. (*Parks* v. *Turner, et al.,* 12 How. 39 (53 U. S.) 13 L. Ed. 883; Vol. 4 Cyc. of Fed. Proc., Section 1463, page 1022.)

Proof of usage or custom in violation of statute, settled rules of law, or public policy, cannot be admitted in evidence. Hence, what was done by other receivers or trustees was entirely immaterial. (*Vermilye* v. *Adams Express Co.,* 21 Wall. (88 U. S.) 138, 22 L. Ed. 609, 612; *Thompson* v. *Riggs,* 5 Wall. (72 U. S.) 663, 18 L. Ed. 704, 708; *Cudahy Packing Co.* v. *Narzisenfeld,* 3 F. (2d) 567, 572 (C. C. A. 2 C.); *Rice* v. *Bakovic,* 53 F. (2d) 890 (D. C. Wash.).)

In commenting on the evidence in a charge to the jury, facts not disputed or disputable, or assumed as true by the issues made, may be assumed as true in the charge. The testimony of Howard and the two bankers introduced on his behalf was within this rule. (*Toland* v. *Sprague,*

12 Pet. 300, 9 L. Ed. 1093; *Missouri Dist. Telegraph Co.* v. *Morris & Co.*, 243 F. 481 (C. C. A. 8 C.) Cert. Den. 245 U. S. 651, 62 L. Ed. 531; *Chambers* v. *Farnham*, 236 F. 886 (C. C. A. 7 C.); *Cloquet Lumber Co.* v. *Burns*, 222 F. 857 (C. C. A. 8 C.); *U. S. Coal Co.* v. *Pinkerton*, 169 F. 536 (C. C. A. 6 C.).)

Independent evidence with respect to the possibility or probability that another bank would keep the Phillip Bank open was incompetent. (Smith-Hurd Ann. St., Ill., Chapter 38, Section 64, and Chapter 16½, Section 9; *Knass* v. *Madison and Kedzie Bank*, 354 Ill. 554, 566, 567, 188 N. E. 836, Appeal Dismissed 292 U. S. 599, 78 L. Ed. 1463.)

A lawyer in making his argument is confined to the facts that are in the record. (*Union Pac. R. Co.* v. *Field*, 137 F. 14, 17 (C. C. A. 8 C.), and cases cited. *Waldron* v. *Waldron*, 156 U. S. 361, 39 L. Ed. 453; *Graves* v. *U. S.*, 150 U. S. 118, 37 L. Ed. 1021.)

Howard was charged with notice of the condition of the bank by published statements issued by the Auditor of Public Accounts of the State of Illinois pursuant to statute. (*McCreary* v. *Schenebeck*, 191 Ark. 698, 87 S. W. (2d) 572, 574.)

It is improper for a lawyer to select a portion of a charge on a particular matter and predicate error thereon. (*Cloquet Lumber Co.* v. *Burns*, 222 F. 857, 861.)

The testimony of the defendants and their witnesses as to Howard's knowledge of the condition of the Phillip Bank constituted a judicial admission and as such is binding on them. (*Waldron* v. *Waldron*, 156 U. S. 361, 39 L. Ed. 453, 22 C. J., Sec. 370, page 330 and Sec. 505, pages 421, 422.)

CONCLUSION.

The plaintiffs submitted competent evidence in the trial court sufficient to justify the jury in finding that the defendant Howard had caused more than $225,740.45 of the plaintiffs' money to be lost because of his negligence or malfeasance as trustee and receiver in bankruptcy of said estates. They further showed that such negligence or malfeasance constituted a violation of Howard's official bonds, thereby making his surety liable to the extent of $225,740.45 of its obligation on such bonds.

The only defense seriously urged was the purely technical one that so long as Howard kept his estate moneys in a designated depository the loss of such moneys could not be chargeable to him, or his surety, regardless of his reasons for, or his negligence in, the selection and use of such depository. The fact that Howard personally had the power and duty to *select* and use one or more depositories among many destroys this defense.

It was suggested by the Circuit Court that Howard might be liable and that his surety might not be liable for such losses. It having been shown that Howard's liability arises out of his violation of his official bonds in the course of performing the duties of his office, this theory is untenable.

This Court has recently recognized some of the difficulties that have arisen in connection with bankruptcy funds that are placed in designated depositories and has adopted an order safeguarding the depository bonds. (General Order LIII.) This order and these safeguards do not meet the present situation as here the depository bond was paid and the loss is for deposits in excess thereof. If the decision of the Circuit Court is permitted to re-

main law, there is no safeguard against depositories bidding against each other by the promise of personal favors to a trustee or receiver, nor any safeguard against negligence on the part of a trustee or receiver in depositing or maintaining bankruptcy funds.

Accordingly, the Circuit Court erred in reversing the judgment of the District Court for the plaintiffs in the amount of $225,740.45, together with costs. The judgment of the Circuit Court should be reversed with suitable directions.

Respectfully submitted,

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